Analysis

Brexit: tax issues on business restructurings

Speed read

It is highly likely that one result of Brexit will be a shake up in the operations of many UK businesses operating cross-border in the EU, especially in the financial services sector, where the loss of passporting rights may require businesses to move to or establish a presence in the remaining EU member states. Such business restructurings will inevitably give rise to tax consequences, which will need to be factored into the decision making process. The provisions of the EU Mergers Directive currently facilitate cross-border restructurings with the EU, but in the absence of co-ordinated action, many of the tax benefits of this Directive will be lost when the UK exits the EU. However, in the absence of any detailed information concerning the nature of and arrangements for the UK's exit, much uncertainty will remain over the consequences of business restructurings taking place post-Brexit. As such, businesses should be considering their options at an early stage and whilst the current legal framework remains in place.

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The exit of the UK from the European Union will have very direct implications for many parts of the UK's tax code. Customs duties and VAT are, in effect, EU taxes; and many other parts of our tax rules are directly impacted by various EU Directives and the fundamental freedoms. However, quite apart from the direct implications for UK taxation, Brexit will most likely result in a great deal of business restructuring, which will in itself give rise to significant tax implications.

In particular, membership of the EU provides a 'passport' to carry on certain regulated business within other EU member states in a range of industries. These include UK based banks and other financial service providers. In the wake of Brexit, UK firms will in principle cease to benefit from the ability to provide services cross-border or to establish branches under relevant passports. At the very least, new licences are likely to be required and businesses may in some cases need to be restructured. The tax implications of any such restructuring will need to be carefully considered.

Restructurings resulting from Brexit are likely to involve the setting up of operations, including subsidiaries and/or branches, in remaining EU member states; and the transfer or migration of existing UK businesses to those member states. The transfer of assets, services and people to any such newly incorporated subsidiaries or branches may have significant tax consequences. In particular, the transfer of assets to a new entity will, in principle, result in a disposal of those assets for tax purposes.

Mergers Directive

At present, the EU Cross-Border Mergers Directive (Council Directive 2009/133) provides for tax relief for mergers between companies incorporated in different EU member states, provided that certain conditions are satisfied. The regime, whilst enacted into English law, derives from EU legislation. When the UK ceases to be a member state, references to 'member states' in the legislation of other EU members will cease to include the UK, meaning relief for such mergers in other member states will, in principle, no longer be available.

The particular tax implications of any restructuring will depend on the exact nature of that restructuring. However, restructurings may generally give rise to a number of different tax considerations, including the following situations.

> Brexit will most likely result in a great deal of business restructuring

Transfer of a UK trade/business

The transfer of a UK business to a new EU entity in return for an issue of shares would currently take place on a no gain, no loss basis, by virtue of the UK's implementation of the EU Mergers Directive (TCGA 1992 s 140A). However, the result of Brexit will be to leave the UK outside the EU. Whilst the provisions of this Directive are enacted into UK law, the UK will cease to be an EU member state when Brexit is effected and s 140A will, in principle, cease to apply on such a merger. Accordingly, any such restructuring taking place after Brexit has become effective may potentially give rise to tax charges on the assets involved in such a transfer which have risen in value. However, it should be noted that TCGA 1992 s 171 may also provide for a no gain no loss transfer in many such cases.

Transfer of a non-UK trade/business

The transfer of a non-UK business by a UK company to a new company in another member state may equally cease to benefit from the current advantageous treatment under the Mergers Directive. References to 'EU member states' in the legislation of other EU members will cease to include the UK. Therefore, any mergers involving assets in other member states will, most likely, no longer benefit from tax relief under the existing framework in that member state following Brexit.

From a UK tax perspective, TCGA 1992 s 140C together with TIOPA 2010 s 122 implements the Mergers

Directive; and this provision gives the UK transferor double tax relief for notional tax which would have been payable in the local member state. Confusingly, the existing provisions of s 140C do not explicitly depend on the UK being part of the EU and so may, technically, continue to apply in the absence of amendment. This serves to exemplify how difficult it may become to apply these provisions following Brexit; and how, in practice, new UK rules will be required.

More generally, TCGA 1992 s 140 provides for a general CGT deferral on the transfer of assets of a non-UK trade to a non-resident company in return for an issue of shares. As such, deferral of gains on the incorporation of an overseas branch should still be possible from a UK tax perspective, even if the Mergers Directive provisions do not survive Brexit. The conditions for the relief are stringent, however, and deferral only applies where the UK company carries on a trade through a permanent establishment, so that relief would not be available for non-trading branches or for assets not used in the trade of the branch.

Furthermore, where an election has been made for the permanent establishment (PE) or branch to be treated as UK tax exempt under CTA 2009 s 18A, then the transfer of the branch assets to a new local subsidiary would also be outside the UK tax provisions.

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Migration

If a business sought to relocate outside the UK following Brexit, then the UK tax rules on corporate migrations will be relevant to consider. For example, a company which ceases to be resident in the UK is deemed to have disposed of and reacquired all of its assets at market value immediately before ceasing to be UK tax resident. This may result in a chargeable gain arising, which would be subject to UK tax.

At present, it may be possible for a company to postpone tax payable, if it becomes resident in an EEA member state and meets a number of other conditions (TMA 1970 Sch 3ZB), but it is far from certain that such relief will continue to apply following Brexit.

Other tax consequences of a transfer/merger

The physical movement of goods from the UK to a remaining member state may give rise to a number of tax issues. Customs duties may be relevant, since the UK will no longer be part of the customs union of the EU in the absence of a new customs agreement. Equally, import VAT may become chargeable on the importation of goods into the EU from the UK.

Tax consequences of the new arrangements

The tax consequences of a reorganisation would not end with the taxation of the actual transaction effecting the reorganisation. There will also be the tax implications of the new arrangements between the UK and other parts of the business going forwards to consider.

For example, it may well be that whilst the business has been transferred to or created in another member state for regulatory purposes, many of the functions, including people functions, might remain in the UK. Clearly, at the very least this would give rise to transfer pricing considerations, with the UK business required to charge an arm's length fee for such services. It is also possible that the diverted profits tax (DPT) provisions may have some impact in this situation were HMRC to consider that the arrangements lacked economic substance.

A UK parent with a new non-UK subsidiary might also have to consider the implications of the UK's controlled foreign companies (CFC) rules, as well as tax issues associated with funding its subsidiary and repatriating profits to the UK. In particular, the payment of dividends and interest free of withholding taxes from EU subsidiaries to a UK parent may no longer be possible without the benefit of the EU Parent Subsidiary Directive (Council Directive 2011/96) and the Interest and Royalties Directive (Council Directive 2003/49), except where the UK's bilateral treaties provide for 0% withholding tax.

In addition, services provided to a new EU subsidiary would be subject to VAT (assuming VAT continued in a form similar to the present rules). In this case, the B2B rules would apply in most cases, however, such that VAT would continue to be charged where the recipient belongs under the reverse charge mechanism. Supplies to EU branches might fall outside the scope of VAT, unless the EU branch was VAT grouped locally, in which case considerations arising from the decision in *Skandia America Corporation USA v Skatteverket* (Case C-7/13) would be relevant.

Brexit may well also have tax consequences for individuals working cross-border in subsidiaries and branches in the UK and other member states. As a member of the EU, the UK is a signatory to the EU Social Security agreement (Regulation (EC) No 883/2004), which essentially provides a mechanism for EU individuals who work in different EU countries to only be subject to the social security regime of one of those countries. Following Brexit, the UK would need to re-sign the agreement in its capacity as a non-EU member (as Switzerland has done, for example) for such arrangements to continue.

Where does this leave us?

It is possible that Brexit will lead to a significant amount of business reorganisation, particularly in the field of financial services, where the benefits of current passporting rules are likely to be lost. The possible tax implications of such business reorganisations should not be underestimated in the absence of the protections currently afforded by the Mergers Directive.

As is the case in all areas of business, the effect of Brexit will, in very large part, depend on the nature of the UK's arrangements to exit the EU and the form of any replacement rules and agreements. In practice, it seems certain that the UK will need to amend or replace the existing UK tax provisions dealing with EU mergers. Nevertheless, in the absence of EU wide action, adverse tax implications may arise in other member states on the incorporation of existing businesses. As a result, whilst much depends on the nature of the post-Brexit relationship between the UK and the EU, businesses likely to be affected should consider their options sooner rather than later, before Brexit actually becomes effective and whilst the current beneficial rules remain in place. ■